



**ORANGE COUNTY** 

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VICE CHAIR ROBERT BOUER Councilmember City of Laguna Woods

BILL CAMPBELL Supervisor Third District

**PETER HERZOG**Councilmember
City of Lake Forest

ARLENE SCHAFER
Director
Costa Mesa
Sanitary District

TOM WILSON Supervisor Fifth District

**JOHN WITHERS**Director
Irvine Ranch Water District

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Councilmember
City of Buena Park

ALTERNATE
RHONDA MCCUNE
Representative of
General Public

ALTERNATE

JAMES W. SILVA
Supervisor
Second District

ALTERNATE
CHARLEY WILSON
Director
Santa Margarita
Water District

JOYCE CROSTHWAITE
Executive Officer

February 8, 2006

TO:

Local Agency Formation Commission

FROM:

**Executive Officer** 

**Assistant Executive Officer** 

**SUBJECT:** 

FY 2004-2005 LAFCO Audit

On June 30, 2005, the Commission ratified a three-year contract with the certified public accounting firm of Moreland & Associates, Inc. to perform annual audits of LAFCO's financial statements. A draft of the audit report for FY 2004-2005 has been completed and is attached for your review.

The audit report consists of three principal components:

- ➤ Transmittal Letter an audit report cover letter from Moreland & Associates, Inc. (Attachment 1) outlining the auditor's professional responsibilities and accounting policies.
- ➤ Orange LAFCO Financial Statements— an independent review of the government activities and each major fund of Orange LAFCO for FY 2004-2005 (Attachment 2).
- ➤ **Government Auditing Standards** a report (Attachment 3) identifying and disclosing the auditor's compliance with current government auditing standards.

During the audit process, the independent auditor did not identify any issues relating to LAFCO's accounting procedures, current internal financial controls or office procedures. Because no irregularities were found, the auditor did not issue a "management letter" which is used to identify issues of concern.

February 8, 2006

RE: 2004-2005 LAFCO Audit

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#### Recommendation

Staff recommends that the Commission:

1. Receive and file the Moreland & Associates transmittal letter, the independent review of Orange LAFCO's financial statements, and the auditor's report on compliance government auditing standards for FY 2004-2005.

Respectfully submitted,

CROSTHWAITE

BOB ALDRICH

#### Attachments:

- 1. Moreland & Associates transmittal letter
- 2. LAFCO 2004-2005 Financial Statements
- 3. Moreland & Associates compliance with government auditing standards

#### ATTACHMENT 1



(949) 221-0025

570 RANCHEROS DRIVE, SUITE 260 SAN MARCOS, CA 92069 (760) 752-3390

August 25, 2005

Members of the Orange County
Local Agency Formation Commission

We have audited the financial statements of the governmental activities and each major fund of the Orange County Local Agency Formation Commission (Commission) for the year ended June 30, 2005, which collectively comprise the Commission's basic financial statements, and have issued our report thereon dated August 25, 2005. Professional standards require that we provide you with the following information related to our audit.

### Our Responsibility under Generally Accepted Auditing Standards and Governmental Auditing Standards

Our responsibility as described by professional standards is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the basic financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of the Orange County Local Agency Formation Commission. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

#### Other Information in Documents Containing Audited Financial Statements

Our responsibility for other information in documents containing the Commission's financial statements and our report thereon does not extend beyond financial information identified in our report, and we have no obligation to perform any procedures to corroborate other information contained in these documents. We have, however, read the other information included in the Commission's annual financial statements; and no matters came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or its manner or presentation, appearing in the financial statements.

Members of the Orange County
Local Agency Formation Commission
August 25, 2005
Page 2

#### Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. We will advise management about the appropriateness of accounting policies and their application. The significant accounting policies of the Commission are described in Note I to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions during the year that were both significant and unusual, or transactions for which there is a lack of authoritative guidance or consensus.

#### Management Judgments and Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based upon management's knowledge and experience about past and current events and assumptions about future events. We noted that the Commission's significant account balances are not dependent upon management's estimates.

#### **Audit Adjustments**

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Orange County Local Agency Formation Commission's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the Orange County Local Agency Formation Commission, either individually or in the aggregate, indicate matters that could have a significant effect on the Commission's financial reporting process.

#### **Disagreements With Management**

There were no disagreements with management on financial accounting, reporting or auditing matters that, if not satisfactorily resolved, that could be significant to the Commission's financial statements or to our auditors' report.

#### Consultation With Other Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

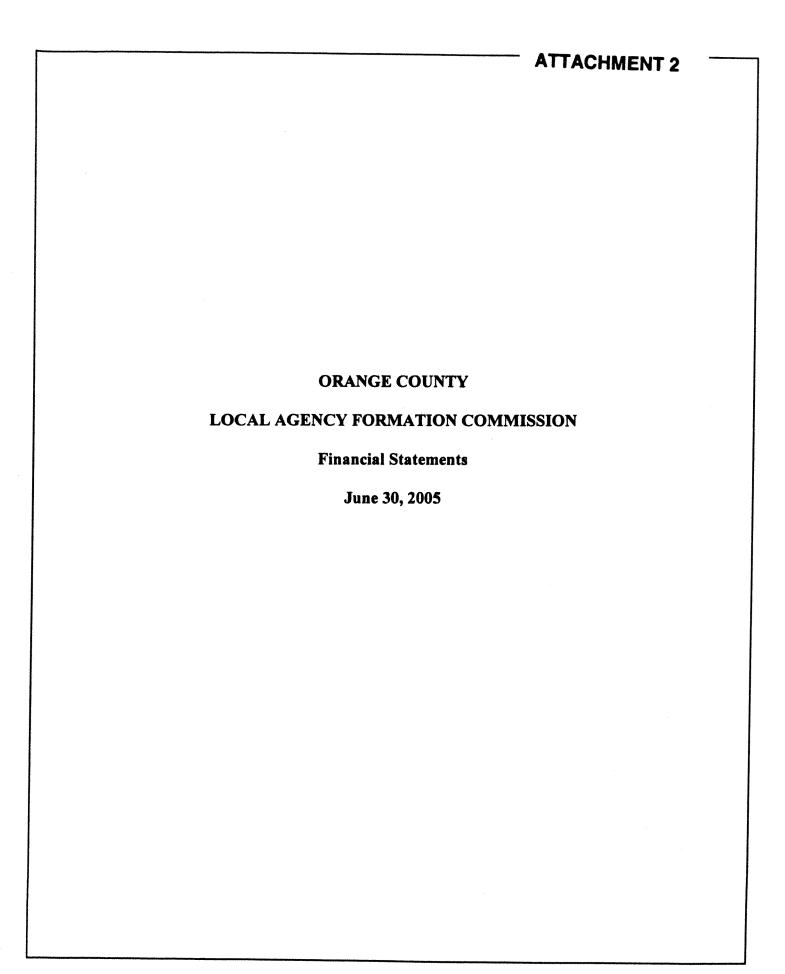
Members of the Orange County
Local Agency Formation Commission
August 25, 2005
Page 3

#### Issues Discussed With Management Prior to Retention

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Commission's auditors. These discussions occurred in the normal course of our professional relationship, and our responses were not a condition to our retention.

This information is intended solely for the information and use of the Commission members and management of the Orange County Local Agency Formation Commission and is not intended to be and should not be used by anyone other than these specified parties.

Mouland & Associates, Suc.



#### Financial Statements June 30, 2005

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570 RANCHEROS DRIVE, SUITE 260 SAN MARCOS, CA 92069 (760) 752-3390

August 25, 2005

Orange County Local Agency Formation Commission

#### **Independent Auditors' Report**

We have audited the accompanying financial statements of the governmental activities and each major fund of the Orange County Local Agency Formation Commission, (Commission), as of and for the year ended June 30, 2005, which collectively comprise the Commission's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Commission's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Orange County Local Agency Formation Commission as of June 30, 2005, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated August 25, 2005 on our consideration of the Commission's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

The management's discussion and analysis and other required supplementary information identified in the accompanying table of contents are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Commission's basic financial statements. The accompanying combining schedules listed as supplementary information in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

1 Moreland Thoristes, Suc.

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#### MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of the financial performance of the Orange County Local Agency Formation Commission provides an overview of the Commission's financial activities for the fiscal year ended June 30, 2005. Please read it in conjunction with the financial statements identified in the accompanying table of contents.

#### Using the Accompanying Financial Statements

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities provide information about the activities of the Commission as a whole and present a longer-term view of the Commission's finances. Also included in the accompanying report are fund financial statements. For governmental activities, the fund financial statements tell how these services were financed in the short term as well as what remains for future spending. Fund financial statements also report the Commission's operations in more detail than the government-wide statements by providing information about the Commission's most significant funds.

#### **OVERVIEW OF THE FINANCIAL STATEMENTS**

The annual report consists of four parts — management's discussion and analysis (this section), the basic financial statements, required supplementary information, and an optional section that presents combining statements for nonmajor governmental funds. The basic financial statements include two kinds of statements that present different views of the Commission:

The first two statements are government-wide financial statements that provide both long-term and short-term information about the Commission's overall financial status. The remaining statements are fund financial statements that focus on individual parts of the Commission government, reporting the Commission's operations in more detail than the government-wide statements.

The financial statements also include *notes* that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of *required supplementary information* that provided additional financial and budgetary information.

#### Reporting the Commission as a Whole

The accompanying government-wide financial statements include two statements that present financial data for the Commission as a whole. One of the most important questions asked about the Commission's finances is, "Is the Commission as a whole better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Activities report information about the Commission as a whole and about its activities in a way that helps answer this question. These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Commission's net assets and changes in them. You can think of the Commission's net assets – the difference between assets and liabilities –as one way to measure the Commission's financial health, or financial position. Over time, increases and decreases in the Commission's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, such as changes in the Commission's revenues, to assess the overall health of the Commission.

#### Reporting the Commission's Major Funds

The fund financial statements provide detailed information about the Commission's most significant funds — not the Commission as a whole. Some funds are required to be established by State law or by bond covenants. However, the Commission establishes many other funds to help it control and manage money for particular purposes or to show that it is meeting administrative responsibilities for using certain revenues.

Governmental funds — All of the Commission's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year end that are available for spending. These funds are reported using an accounting method called modified accrual accounting, which measures cash and all other current financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view of the Commission's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the Commission's programs. We describe the relationship or differences between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds in a reconciliation following the fund financial statements.

#### **GOVERNMENT-WIDE FINANCIAL STATEMENTS**

Table 1

A summary of the government-wide statement of net assets follows:

#### Net Assets - Governmental Activities 2005 2004 Difference Assets Capital assets, net \$ 58,463 \$ 70,727 \$ (12,264) Other assets 559,710 565,083 (5.373)Total assets 618,173 635,810 (17,637) Liabilities Long-term liabilities 35,493 70,532 (35,039)Other liabilities 63,295 68.871 (5,576)Total liabilities 98,788 139,403 (40,615)Net assets Invested in capital assets 58,463 70,727 (12,264)Unrestricted 460,922 425,680 35,242 Total net assets \$519,385 \$ 496,407 \$ 22,978

A summary of the government-wide statement of activities follows:

Table 2
Changes in Net Assets – Governmental Activities

Revenues	<u>2005</u>	<u>2004</u>	Difference
Program revenues:			
Charges for services	\$1,037,197	\$1,139,000	\$(101,803)
General revenues:	<b>4-,</b> ,	<b>41,111,11</b>	<b>(</b> (,)
Interest	10,593	11,738	(1,145)
Other	9,800	1,563	8,237
Total revenues	1,057,590	1,152,301	(94,711)
Expenses			
Program expenses:			
Salaries and benefits	691,150	676,933	14,217
Services and supplies	343,462	439,118	<u>(95,656)</u>
Total expenses	1,034,612	1,116,051	(81,439)
Change in net assets	22,978	36,250	(13,272)
Net assets at beginning of year Net assets at end of year	496,407 \$ 519.385	460,157 \$ 496,407	36,250 \$ 22,978

The increase or decrease in net assets can provide an indication as to whether the overall financial position of the Commission improved or deteriorated during the year. Net assets of the Commission increased by \$22,978.

The reasons for significant changes in the revenues and expenses of the Commissions' governmental activities presented above are as follows:

- The Commission was able to keep expenses within the approved budget.
- The major revenue source during the year was the Commission's apportionment in the amount of \$930,920. The budgeted apportionment has remained constant for the last five years. Charges for services declined by \$101,803 from the prior year due to special one time projects in fiscal year ending June 30, 2004.
- The major expense during the year was salaries and benefits totaling \$691,150. Salaries and benefits increased \$14,217 (21%) since the prior year primarily due to Increases in OCERS retirement contributions and increases in health insurance.

#### **MAJOR FUNDS**

As noted earlier, the Commission uses fund accounting to provide proper financial management of the Commission's resources and to demonstrate compliance with finance-related legal requirements.

Major Governmental Funds. The General Fund is the chief operating fund of the Commission. At the end of the current fiscal year, unreserved fund balance of the general fund was \$99,827 compared to \$156,237 in fiscal year ended June 30, 2004. Total fund balance in the general fund at June 30, 2005 was \$276,878, which is a \$7,226 increase from the prior year.

General Fund revenues remained consistent from the prior year. General Fund salaries and benefits increased due to an increase in the OCERS required retirement contribution and an increase in health benefits.

#### **GENERAL FUND BUDGET**

Major deviations between the budget of the General Fund and its actual operating results were as follows:

- Charges for services exceeded the budget by \$36,720 due to an unexpected increase in applications for city and special district annexations.
- Salaries and benefits were less than budgeted because the Executive Director's position was vacant in the beginning of the year and because the County of Orange's estimates of benefits were higher than actual.
- Services and supplies were less than budgeted because the Commission utilized less professional services than anticipated.

#### **CAPITAL ASSETS**

## Capital Assets – Governmental Activities (net of depreciation)

	2005	2004	<u>Difference</u>
Furniture and fixtures	\$ 30,601	\$ 30,601	
Equipment	32,947	30,522	\$ 2,425
Leasehold improvements	40,361	40,361	errore de la constitución de la
Total	<u>\$103.909</u>	\$101.48 <b>4</b>	<u>\$ 2.425</u>

There were no major additions to capital assets for the year ended June 30, 2005.

#### **LONG-TERM LIABILITIES**

	2005	2004	Difference
Compensated absences	<u>\$ 35.493</u>	<u>\$ 70.532</u>	<u>\$ (35.039)</u>

Additional information on the Commission's capital assets and long-term liabilities can be found in notes 3 and 6 to the accompanying financial statements.

#### Contacting the Commission's Financial Management

This financial report is designed to provide our citizens, taxpayers, customers, and creditors with a general overview of the Commission's finances and to show the Commission's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Executive Officer at 12 Civic Center Plaza, Room 235, Santa Ana, CA 92701

# Statement of Net Assets June 30, 2005

ASSETS	Governmental Activities
Cash and investments	\$ 538,617
Due from other governments	10 <b>,787</b>
Prepaid expenses	9 <b>,</b> 98 <b>9</b>
Interest recevable	317
Capital assets net of accumulated depreciation	58,463
Total Assets	618,173
LIABILITIES	
Accounts payable and accrued liabilities	50,730
Deferred revenue	10,787
Due to other governments	1,778
Noncurrent liabilities:	•
Due in more than one year	35,493
Total Liabilities	98,788
NET ASSETS	
Invested in capital assets	58,463
Unrestricted	460,922
Total Net Assets	\$ 519,385

# Statement of Activities For the Year Ended June 30, 2005

Functions/Programs	Expenses	Charges for Services	Governmental Activities
Governmental activities: Salaries and benefits Services and supplies	\$ 691,150 343,462	<b>\$</b> 1,037,197	\$ 346,047 (343,462)
Total Governmental Activities	\$ 1,034,612	\$ 1,037,197	2,585
General Revenu Interest Other	es:		10,593 9,800
Total General R	evenues		20,393
Change in Net A	Assets		22,978
Net Assets - Beg	ginning of Year		496,407
Net Assets - End of Year			\$ 519,385

Balance Sheet June 30, 2005

	General Fund	Special Revenue Fund	Total
<u>Assets</u>			
Cash and investments	\$ 305,615	\$ 233,002	\$ 538,617
Due from other funds	13,465		13,465
Due from other governments		10,787	10,787
Prepaid expenses	9,989		9,989
Interest receivable	317		317
Total Assets	\$ 329,386	\$ 243,789	\$ 573,175
<u>Liabilities</u>			
Liabilities:			
Accounts payable and accrued liabilities	\$ 50,730		\$ 50,730
Due to other funds		\$ 13,465	13,465
Deferred revenue		10,787	10,787
Due to other governments	1,778	***************************************	1,778
Total Liabilities	52,508	24,252	76,760
Fund Balances			
Reserved for litigation	75,000		75,000
Reserved for encumbrances	1,851		1,851
Reserved for petty cash	200		200
Reserved for special projects		233,002	233,002
Reserved for contingency	100,000		100,000
Undesignated	99,827	(13,465)	86,362
Total Fund Balances	276,878	219,537	496,415
Total Liabilities and Fund Balances	\$ 329,386	\$ 243,789	\$ 573,175

# ORANGE COUNTY LOCAL AGENCY FORMATION COMMISSION Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets June 30, 2005

Total fund balance, governmental funds

Amounts reported for governmental activities in the Statement of Net Assets are different because:	\$ 496,415
Capital assets used in governmental activities are not current financial resources and therefore are not reported in the funds.	58,463
Long-term liabilities, such as compensated absences are not due and payable in the current period and therefore are not reported in the	
funds.	 (35,493)
Net Assets of Governmental Activities	\$ 519,385

# Statement of Revenues, Expenditures and Changes in Fund Balances

For the Year Ended June 30, 2005

•	General Fund	Special Revenue Fund	Total		
Revenues:					
Charges for services:					
Assessment	\$ 930,918		\$ 930,918		
Filing fees	56,329	\$ 49,950	106,279		
Interest	10,593		10,593		
Other	9,800		9,800		
Total Revenues	1,007,640	49,950	1,057,590		
Expenditures:					
Salaries and benefits	691,150		691,150		
Services and supplies	309,264	56,973	366,237		
Total Expenditures	1,000,414	56,973	1,057,387		
Excess (Deficiency) of Revenues Over					
Expenditures	7,226	(7,023)	203		
Fund Balances, Beginning	269,652	226,560	496,212		
Fund Balances, Ending	\$ 276,878	\$ 219,537	\$ 496,415		

Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds to the Statement of Activities
For the Year Ended June 30, 2005

Net change in fund balances - total governmental funds:

203

Amounts reported for governmental activities in the statement of activities are different because:

Governmental funds report services and supplies as expenditures. However, in the statement of activities, the costs of capital assets included in services and supplies is allocated over their estimated useful lives and reported as depreciation expense.

Capital outlay \$ 2,425

Depreciation (14,689) (12,264)

Long-term liabilities, such as compensated absences are not due and payable in the current period and therefore are not reported in the funds.

35,039

Change in Net Assets of Governmental Activities

\$ 22,978

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Notes to Financial Statements
June 30, 2005

#### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Orange County Local Agency Formation Commission (Commission) conform to generally accepted accounting principles as applicable to governments. The following is a summary of the significant policies.

#### A. <u>Description of the Reporting Entity</u>

Following the end of World War II, California entered a new era of demographic growth and diversity, and economic development. With this growth came the need for housing, jobs and public services. To provide for these services, California experienced a wave of newly formed cities and special districts, but with little forethought as to how the new agencies should plan for services. The lack of coordination and adequate planning for future governance led to a multitude of overlapping, inefficient jurisdictional and service boundaries.

In 1963, the State Legislature created Local Agency Formation Commissions (Commissions) to help direct and coordinate California's growth in a logical, efficient, and orderly manner. Each county within California is required to have a Commission. The Commissions are charged with the responsibility of making difficult decisions on proposals for new cities and special districts, spheres of influence, consolidations, and annexations.

Prior to July 1, 2001, the Commission was a department of the County of Orange. The Commission has separated from the County and is now independent. The Commission's governing board consists of seven appointed board members. Two members are selected by the Orange County Board of Supervisors from their own membership, two are selected by the cities in the County, two are selected from special districts by the independent special district selection committee and one member is selected to represent the general public, who is appointed by the other members of the Commission.

Funding for the Commission operations is equally shared by the County, the 34 Orange County cities and the 26 independent special districts. Although the County of Orange contributes one-third of the Commission funding, the Commission is an independent agency and its budget is not subject to County approval.

- The Commission and County of Orange entered into a County Services Agreement to provide all accounting, banking/investment and insurance services for the Commission. In FY 2004-05 this agreement was modified and after the modification, the County of Orange provides only payroll related services to the Commission.

Notes to Financial Statements (Continued)
June 30, 2005

- The Commission is staffed by a total of six full-time staff, two of which are limited term assignments.

#### B. Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the activities of the Commission.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include charges for services that are restricted to meeting the operational or capital requirements of a particular function or segment. Use of money and other items not properly included among program revenues are reported instead as general revenues.

Separate financial statements are provided for governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements.

The Commission reports the following major governmental funds:

The General Fund is used to account for resources traditionally associated with the government, which are not required legally or by sound financial management to be accounted for in another fund.

The Special Revenue Fund is used to account for resources derived from the specific revenue sources which are usually required by law or administrative regulation to be accounted for in separate funds. The Commission utilizes this fund to account for the different project areas.

#### C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when the liability is incurred, regardless of the timing of the related cash flows.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period.

Notes to Financial Statements (Continued)
June 30, 2005

For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal year. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, expenditures related to compensated absences are not recognized until paid.

Charges for services and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the government.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements.

Amounts reported as program revenues include charges to members. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

When both restricted and unrestricted resources are available for use, it is the Commission's policy to use restricted resources first, and then use unrestricted resources as needed.

#### C. Capital Assets

Capital assets are not capitalized in the funds used to acquire or construct them. Instead, capital acquisition and construction costs are reflected as expenditures in governmental funds. The related assets are reported in the Statement of Net Assets. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. All purchased capital assets are recorded at cost or estimated historical cost. Donated (contributed) capital assets are valued at their estimated fair market value on the date received. Depreciation is charged to operations using the straight-line method over the estimated useful lives of the assets.

#### D. <u>Investments</u>

Investments are stated at fair value (the value at which a financial instrument could be exchanged, other than in a forced or liquidation sale), in accordance with Government Accounting Standards Board (GASB) Statement 31.

Notes to Financial Statements (Continued)
June 30, 2005

#### E. Budgets and Budgetary Accounting

The Commission established accounting control through formal adoption of an annual operating budget for the general fund. The operating budget is prepared on a basis consistent with generally accepted accounting principles. An annual appropriated budget is adopted for the general fund. The adopted budget can be amended by the Commission to change both appropriations and estimated revenues as unforeseen circumstances come to management's attention. Increases and decreases in revenue and appropriations and transfers between funds require Commission's approval. However, the Chief Executive Officer may authorize changes within funds. Expenditures may not exceed total appropriations at the individual fund level. It is the practice of the Commission's management to review the budget mid-year and, if necessary, recommend changes to the Commission. Budgets are not prepared for the Special Revenue Fund.

#### 2. CASH AND INVESTMENTS

The Commission adopted Statement 40 of the Governmental Accounting Standards Board, *Deposit and Investment Risk Disclosures*, during the fiscal year ending June 30, 2005.

Cash and investments as of June 30, 2005 consist of the following:

Petty cash	\$	200
Demand deposits	538,	417
Total Cash and Investments	\$ 538,	617
	<del>\$ 550,</del>	_

#### Investments Authorized by the Commission's Investment Policy

The Commission's investment policy authorizes investments in the under-mentioned agencies/institutions:

- State Local Agency Investment Fund (LAIF).
- U.S. Government and Agencies obligations
- Negotiable Certificates of Deposit issued by a nationally or state chartered bank, a state or federal savings and loan association, or savings bank with ratings equivalent by Fitch to F1 or better.

# ORANGE COUNTY LOCAL AGENCY FORMATION COMMISSION Notes to Financial Statements (Continued)

June 30, 2005

#### Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the Commission manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

As of June 30, 2005, the Commission had investments in the form of bank savings account and as such it was not exposed to any interest rate risk as described above.

#### Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The bank balances are not subject to credit rating.

#### Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the Commission's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure Authority deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

At June 30, 2005 \$438,417 the Commission's deposits with financial institutions in excess of federal depository insurance limits were hold in uncollateralized accounts.

Notes to Financial Statements (Continued)
June 30, 2005

With respect to investments, custodial credit risk generally applies only to direct investments in marketable securities. Custodial credit risk does not apply to a local government's indirect investment insecurities through the use of mutual funds or government investment pools (such as LAIF).

#### 3. CAPITAL ASSETS

Changes in the Capital Assets for the year ended June 30, 2004 were as follows:

	Restated Balance ly 1, 2004		Additions	Deletions		Balance ne 30, 2005
Furniture and Fixtures	\$ 30,601				S	30,601
Equipment	30,522	\$	2,425		•	32,947
Leasehold Improvement	 40,361			-		40,361
Total Capital Assets	101,484		2,425			103,909
Accumulated Depreciation	 (30,757)	-	(14,689)			(45,446)
Total Capital Assets, Net	\$ 70,727	<u>\$</u>	(12,264)	<u>s - </u>	<u>\$</u>	58,463

Depreciation expense of \$14,689 was charged to services and supplies.

#### 4. <u>DUE FROM OTHER GOVERNMENTS</u>

The amount reported as "Due from other governments" consists of amounts due from the Tonner Hills area in the amount of \$10,787.

#### 5. **INSURANCE**

Insurance is provided on behalf of the commission by the County of Orange Insurance Policy. The Commission pays its pro-rata share of insurance costs to the County. For coverage limits see the County of Orange Comprehensive Annual Financial Report.

This report can be obtained at the Auditor-Controller County of Orange office located at Hall of Finance and Records, 12 Civic Center Plaza, Room 202, Santa Ana, CA 92702.

Notes to Financial Statements (Continued)
June 30, 2005

#### 6. COMPENSATED ABSENCES

The Commission had compensated absences outstanding at June 30, 2005 in the amount of \$35,493.

#### 7. RETIREMENT PLAN

#### Plan Description

The Commission participates in the Orange County Employees' Retirement System (OCERS), a cost-sharing multiple-employer, defined benefit pension plan. OCERS was established in 1945 under the provisions of the County Employees Retirement Law of 1937, and provides members with retirement, death, disability, and cost-of-living benefits. The Commission's payroll of employees covered by OCERS was \$498,267 for the year ended June 30, 2005; the Commission's total payroll was \$514,655 in Fiscal Year 2004-2005. OCERS issues a publicly available financial report that includes financial statements and required supplementary information for the Commission. The report can be obtained from OCERS at 2223 Wellington Avenue, Santa Ana, CA 92701.

#### **Funding**

The OCERS pension plan covers substantially all full-time and part-time employees (over 20 hours per pay period) of the Orange County Local Agency Formation Commission, the County of Orange, and several other cities and special districts within the County. Each of the participating entities shares proportionally in all risks and costs. One actuarial valuation is performed of OCERS as a whole, and the same contribution rates apply to each participating entity. The funding policy for participating agencies is to make periodic contributions to OCERS in amounts such that, when combined with employees' contributions and with investment income, will fully provide for all employees' benefits by the time they retire. The Commission's policy is to pay both the employer's contributions and the employees' contributions to the plan pursuant to Government Code Section 31581.1 and 31581.2, respectively.

#### Benefits

All of the Commission's full-time employees participate in OCERS. Employees who retire at or after age 50 with ten or more years of service are entitled to an annual retirement allowance. The amount of the retirement allowance is based upon the member's age at retirement, the member's "final compensation" as defined in Section 31462 of the Retirement Law of 1937, the total years of service under OCERS, and the employee's classification as a Tier I and Tier II member. Benefits fully vest on reaching five years of service. OCERS also provides death and disability benefits.

Notes to Financial Statements (Continued)
June 30, 2005

#### Contributions

The Commission pays the County of Orange for their pro-rata share of OCERS coverage. For contributions from the County, see the County Comprehensive Annual Financial Report. The total amount of OCERS contributions for the year ended June 30, 2005 from the Commission was \$88,460.

#### 8. OTHER POST-EMPLOYMENT BENEFITS

In addition to the retirement plan described in Note 7, the Commission provides a postemployment medical retirement plan for full-time employees. All full-time employees contribute one percent of their gross pay toward the medical retirement plan. Upon retirement, the retired employees are eligible to receive their benefit as a monthly credit towards the cost of the retired employees' medical insurance. The amount of the monthly benefit is based on the retiree's years of credited service. As of June 30, 2005, there were no retirees eligible to receive monthly retiree medical benefits. Employees who separate from the Commission prior to retirement age are eligible to receive their benefit as a lump sum payment. There were no payments made during Fiscal Year 2004-2005.

#### 9. **COMMITMENTS**

The Commission is obligated under operating lease agreements for the rental of office space and various equipment. Future minimum lease payments under these operating leases are as follows:

Fiscal Year	Amount
2006	\$ 31,208
2007	32,641
2008	33,625
2009	34,630
Total	<b>\$</b> 132,104

Additionally, the rental agreement which is included in the County Services Agreement between the County of Orange and the Commission may be terminated by either party at any time. Current annual rent payments are \$27,778 and are included in the schedule above.

**Required Supplementary Information** 

#### General Fund

#### Budgetary Comparison Schedule For the Year Ended June 30, 2005

	Orignial/ Final Budget	Actual	Variance Positive (Negative)
Revenues:			
Charges for services:			
Assessment	\$ 930,920	\$ 930,918	<b>\$</b> (2)
Filing fees	20,000	56,329	36,329
Interest	20,000	10,593	(9,407)
Other		9,800	9,800
Total Revenues	970,920	1,007,640	36,720
Expenditures:			
Salaries and benefits	776,097	691,150	84,947
Services and supplies	368,713	309,263	59,450
Total Expenditures	1,144,810	1,000,413	144,397
Net Change in Fund Balance	(173,890)	7,227	181,117
Fund Balances, Beginning	269,652	269,652	
Fund Balances, Ending	\$ 269,652	\$ 276,879	\$ 7,227

# ORANGE COUNTY LOCAL AGENCY FORMATION COMMISSION Note to Required Supplementary Information June 30, 2005

#### **Budgets and Budgetary Accounting**

The Commission established accounting control through formal adoption of an annual operating budget for the general fund. The operating budget is prepared on a basis consistent with generally accepted accounting principles. An annual appropriated budget is adopted for the general fund. The adopted budget can be amended by the Commission to change both appropriations and estimated revenues as unforeseen circumstances come to management's attention. Increases and decreases in revenue and appropriations and transfers between funds require Commission's approval. However, the Chief Executive Officer may authorize changes within funds. Expenditures may not exceed total appropriations at the individual fund level. It is the practice of the Commission's management to review the budget mid-year and, if necessary, recommend changes to the Commission. Budgets are not prepared for the Special Revenue Fund.

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Supplementary Information

#### Combining Balance Sheet Schedule Special Revenue Fund - Project Areas June 30, 2005

Assets	Islands	East Orange	Irvine El Toro	Talega
Cash and investments  Due from other governments	\$ 51,626		\$ 48,936	\$ 132,440
Total Assets	\$ 51,626	<u>\$ -</u>	\$ 48,936	\$ 132,440
Liabilities				
Due to other funds Deferred revenue		\$ 2,678		
Total Liabilities		2,678	areas and a second a second and	
Fund Balances	•			
Reserved for special projects Undesignated	\$ 51,626	(2,678)	\$ 48,936	\$ 132,440
Total Fund Balances	51,626	(2,678)	48,936	132,440
Total Liabilities and Fund Balances	\$ 51,626	<u>s</u> -	\$ 48,936	<b>\$</b> 132,440

Tonner Hills	Total	
	\$ 233,002	
\$ 10,787	10,787	
\$ 10,787	\$ 243,789	
\$ 10,787 10,787	\$ 13,465 10,787	
21,574	24,252	
(10,787)	233,002 (13,465)	
(10,787)	219,537	
\$ 10,787	\$ 243,789	

### Combining Schedule of Revenues, Expenditures and

# Changes in Fund Balances Special Revenue Fund - Project Areas

For the Year Ended June 30, 2005

	Islands	East Orange	Irvine El Toro	Talega
Revenues:				
Charges for services	\$ 7,900	***************************************		\$ 42,050
Expenditures:				
Current:				
Salaries and benefits				
Services and supplies	5,250	\$ 39,937	\$ 695	304
Total Expenditures	5,250	39,937	695	304
Net Change in Fund Balances	2,650	(39,937)	(695)	41,746
Fund Balances, Beginning	48,976	37,259	49,631	90,694
Fund Balances (Deficits), Ending	\$ 51,626	\$ (2,678)	\$ 48,936	\$ 132,440

Tonner Hills	Total
	\$ 49,950
\$ 10,787	56,973
10,787	56,973
(10,787)	(7,023)
	226,560
\$ (10.787)	\$ 219.527

#### **ATTACHMENT 3**

oreland & Associates, Inc.

CERTIFIED PUBLIC ACCOUNTANTS

(949) 221-0025

570 RANCHEROS DRIVE, SUITE 260 SAN MARCOS, CA 92069 (760) 752-3390

August 25, 2005

Members of the Orange County Local Agency Formation Commission

Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance With Government Auditing Standards

We have audited the financial statements of the government activities and each major fund of the Orange County Local Agency Formation Commission (Commission) as of and for the year ended June 30, 2005, which collectively comprise the Commission's basic financial statements, and have issued our report thereon dated August 25, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

#### Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Orange County Local Agency Formation Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Member of the
Orange County Local Agency
Formation Commission's
August 25, 2005
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#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Orange County Local Agency Formation Commission's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under <u>Government Auditing Standards</u>.

This report is intended solely for the information and use of the Commission members and management of the Orange County Local Agency Formation Commission and is not intended to be and should not be used by anyone other than these specified parties.

Mouland & Associates, Inc.